

Message Text

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ACTION ARA-14

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E.O. 11652: N/A
TAGS: ECON, EFIN, EAGR, ETRD, PA
SUBJ: ECONOMIC ALERT REPORT - PARAGUAY

REF: STATE 180067 ASUNCION A-54 AND A-55

1. SUMMARY. PROSPECTS FOR PARAGUAY'S ECONOMY OVER THE NEXT TWELVE MONTHS ARE GOOD AND THERE IS LITTLE LIKELIHOOD THAT THERE WILL BE ANY ECONOMIC DIFFICULTIES OF SUFFICIENT MAGNITUDE TO AFFECT U.S. INTERESTS SIGNIFICANTLY. MAJOR SHORT-RUN PROBLEM IS SHARP INCREASE IN INFLATION RATE (FROM 6 PERCENT TO AN ESTIMATED 15 PERCENT PER ANNUM, OR HIGHER); MAJOR LONG-RUN PROBLEM IS PLANNING MOST EFFECTIVE USE OF CURRENT INCOME TO PROVIDE FOR LONG-TERM DEVELOPMENT. END SUMMARY.

2. MAJOR ECONOMIC PROBLEMS. (A) KEY TROUBLE AREA FOR NEXT TWELVE MONTHS IS INFLATION RATE, WHICH BEGAN TO CLIMB IN EARLY 1977 TO AN ESTIMATED ANNUAL RATE OF 15 PERCENT, AFTER TWO STABLE YEARS WHEN THE COST OF LIVING INCREASE AVERAGED

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6 PERCENT ANNUALLY. ALTHOUGH PARTIALLY CAUSED BY HIGHER EXTERNAL PRICES AND GROWING DOMESTIC DEMAND FOR CONSUMER GOODS, INFLATIONARY TRENDS HAVE BEEN STRONGLY REINFORCED BY THE INFLOW OF FUNDS FROM THE ITAIPU HYDROELECTRIC PROJECT AND FOREIGN EXCHANGE FROM INCREASED EXPORTS. THE GOVERNMENT HAS SO FAR FAILED TO TAKE ANY ACTION TO ENCOURAGE IMPORTS OR TO CUT BACK IN ANY WAY THE RATE OF INCREASE OF

THE COUNTRY'S INTERNATIONAL RESERVES. (B) OVER THE LONGER TERM, THE CHIEF ECONOMIC DIFFICULTIES WILL ARISE FROM THE APPARENT INABILITY OF THE GOP TO TAKE FULL ADVANTAGE OF CURRENT PERIOD OF HIGH EXPORTS AND CAPITAL INFLOWS TO INCREASE INVESTMENT IN INFRASTRUCTURE AND TO PREPARE TO MAKE THE MOST PRODUCTIVE USE OF THE LARGE SUPPLIES OF ELECTRIC ENERGY WHICH WILL BECOME AVAILABLE IN 1983.

3. OUTLOOK FOR NEXT TWELVE MONTHS. PROSPECTS FOR NEXT TWELVE MONTHS ARE EXCELLENT WITH REAL GROWTH EXPECTED TO BE BETWEEN 6.5 AND 7 PERCENT. LEADING GROWTH SECTORS ARE EXPECTED TO BE CONSTRUCTION ACTIVITIES AND EXPORTS, WITH THE LATTER BASED ON INCREASED PRODUCTION OF COTTON AND SOYBEANS. FOREIGN EXCHANGE RESERVES SHOULD CONTINUE TO INCREASE, AS A RESULT OF THE CONTINUED INFLOW FROM THE ITAIPU HYDROELECTRIC PROJECT AND EXPECTED INVESTMENT FROM ABROAD. BOTH EXPORTS AND IMPORTS SHOULD INCREASE.

4. CRITICAL FACTORS (A) THE ITAIPU HYDROELECTRIC PROJECT IS THE SINGLE BIGGEST FACTOR IN THE PARAGUAYAN ECONOMY PROVIDING CAPITAL INFLOWS, AN OUTLET FOR GOODS AND SERVICES, AND EMPLOYMENT OPPORTUNITIES. A BRAZILIAN DECISION TO SLOW DOWN THE PROJECT COULD, DEPENDING ON THE DEGREE OF CUT-BACK, HAVE SERIOUS EFFECTS ON THE ECONOMY, INCLUDING A SHIFT FROM POSITIVE TO NEGATIVE BALANCE OF PAYMENTS. (B) WEATHER (PARTICULARLY TIMING OF RAINS) WILL BE OF LIMITED OFFICIAL USE

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KEY IMPORTANCE FOR BOTH DOMESTIC ECONOMY AND BALANCE OF PAYMENTS SINCE AGRICULTURE AND AGRO INDUSTRIES PROVIDE 35 PERCENT OF GNP, 95 PERCENT OF EXPORTS AND 50 PERCENT OF EMPLOYMENT OPPORTUNITIES. (C) GOVERNMENT ACTION AGAINST INFLATION, PERHAPS BY ENCOURAGING IMPORTS, IS OF IMPORTANCE IF PARAGUAY IS NOT TO FALL INTO THE INFLATIONARY EXPECTATION SYNDROME. IN ADDITION, WITHIN THE NEXT 4 TO 6 WEEKS GOP MUST DECIDE WHETHER TO MAINTAIN ITS ELECTRICAL NETWORK AT 50 CYCLES OR TO TRANSFORM THE SYSTEM TO 60 CYCLES TO MATCH BRAZIL'S. IF THE GOVERNMENT OPTS FOR THE LATTER, INFLATIONARY PRESSURES WILL INCREASE, AT LEAST IN THE SHORT RUN. STILL A THIRD AREA FOR GOVERNMENT DECISION IS IN THE HUMAN RIGHTS FIELD. UNLESS PARAGUAY ALLOWS A VISIT BY THE INTER-AMERICAN HUMAN RIGHTS COMMISSION, THE USG MIGHT VETO FURTHER SOFT LOANS FROM THE IDB. IF PARAGUAY IS THEREBY FORCED TO ACCEPT HIGHER INTEREST RATES AND SHORTER TERMS FOR NEW LOANS, SERVICING AND REPAYMENT WILL PLACE MORE OF A BURDEN ON BOTH THE GOVERNMENT BUDGET AND THE BALANCE OF PAYMENTS.

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